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THE NATIONAL CITY BANK OF NEW YORK

1931

Economic Conditions
Governmental Finance
United States Securities

New York, December, 1931.

General Business Conditions

THE general course of business during the past month has been disappointing, in view of the hopefulness generated by the rise of grain prices in the fore part. The most experienced observers of periods of depression in this country have held the opinion that the way out this time, as so often in the past, would be provided by a rise in the prices of the farm staples. Moreover, it has been the common opinion in the grain trade that the Russian crop of last year was a phenomenal one, not likely to be repeated immediately, or possibly for some time. These opinions may be correct, but however that may be, the rise of 20 cents per bushel in wheat was too great to hold, in view of the fact that so little information about the Russian crop was available, and the world stocks are large. The decline that followed has been depressing to sentiment generally, for there has been little in the trade news to offset it. Nevertheless the consolatory proof remains that wheat will advance upon any show of a reduction of supplies to moderate proportions. That is quite certain to come as a result of the price situation.

The reaction during the past few days from the advance in commodity prices, and the failure of the bond market to show any sustained firmness, are warnings against deductions that recovery is just around the corner. The "better feeling" which has been noted is delicate, and requires constant nourishment. If the term means only that people are more calmly and patiently enduring conditions, rather than actively cooperating in correcting them, we fear the feeling will not last long, and is not a dependable barometer of business. If, on the other hand, the interpretation can be made that people are more generally facing the required readjustments, and are individually and collectively making them, the improved sentiment constitutes an important advance toward recovery. These readjustments require the cooperation of all classes and divisions of the population, and all countries, and this cooperation is accorded but slowly even after the lessons taught by two years of depression.

Fortunately a practical people take a practical view of their problems, after experience has clarified them. Individual business men have already done so, and have made notable progress in cost reduction, which is one of the essentials in the situation. That this progress will continue, that it will involve more wage reductions and more economies in distributing costs so that the ensuing savings may be more completely passed on and balance restored between prices and purchasing power, is probable. The rate at which these readjustments are made will be largely the rate of recovery from the depression.

Of the international problems pressing for solution that of the German debts is the most important. They are discussed subsequently in this Letter. The world is awaiting hopefully the outcome of the impending conferences, both with respect to reparations and to the short-term debts included under the Stillhaltung agreement.

Banking Conditions

The banking situation has improved. The concern that was manifested in Europe early in October concerning conditions in the United States soon disappeared, the spectacular gold movement ceased and the net import movement due to our creditor position has been resumed in large volume. The gain of $93,500,000 in gold during November (through the 25th) was the largest of any month, except June of this year, since 1917. We do not regard this inward movement with satisfaction, for it indicates that disorder still exists in world trade, but mention it in contrast with the disorderly outward movement which preceded it.

Within this country, the number of bank suspensions, while still seriously large, has declined steadily since the first half of October, and the abnormal expansion of currency in circulation caused by hoarding and banking disturbances came to a halt about the same time. The following table gives bank failures

(8)

as compiled by the American Banker for weeks ended Friday, and the changes in circulation for weeks ended Wednesday:

Week Ended	Number of Bank Failures	Week Ended	Change in Currency in Circulation
Oct. 2	95	Sept. 30	+ 82
9	166	Oct. 7	+185
16	119	14	+ 42
23	109	21	+ 31
30	70	28	— 24
Nov. 6	76	Nov. 4	+ 63
13	52	11	— 26
20	30	18	— 46
27	30	25	+ 8

The increase of $63,000,000 in circulation during the first week of November was due to the coincidence of the month-end, with its special requirements for currency for wage and dividend disbursements, the week-end, with its usual shopping and travelling needs, and the Election Day holiday, always an important shopping day. The subsequent declines were in part normal, but were greater than expected at this season, when expanding retail business is leading up to the yearly peak of currency requirements reached at Christmas time.

These figures supply evidence that the rise of fear among bank depositors for the safety of their money has been checked, and that the cooperative efforts of the banking system to support solvent banks have been effective in dispelling panic.

National Credit Corporation and Federal Home Loan Board

The subsidence of the banking panic during November demonstrates the value of the supporting measures undertaken in October, and notably the organization of the National Credit Corporation. It was realized at the time that the fewer loans this Corporation made the more successful it would be, and by that test it has been an outstanding success. On November 17 President Mortimer N. Buckner announced that subscriptions to the Corporation's notes in excess of the $500,000,000 originally asked by President Hoover were indicated, and that while a call for the payment of 10 per cent of the banks' subscriptions had been authorized it had not been necessary to issue it. Loans have been made, but they have been small in number and amount, and the funds have been provided by individual banks which made advances pending the time when requirements would be large enough to make a call for payment on subscriptions advisable.

On November 13 President Hoover announced a second major project for support of the situation. He outlined a plan that he will present to Congress for the establishment of a system of home loan discount banks to release frozen mortgage loans on homes and farms, and to promote a revival of home building. It is proposed that twelve of these banks be established, one in each Federal Reserve district, under the direction of a Federal Home Loan Board; that their capital be subscribed by building and loan associations, savings banks, deposit banks, farm loan banks, etc. (initially by the government if necessary), and augmented by the sale of bonds or notes to investors; and that conservative loans be made to the subscribers upon their notes secured by mortgages limited to a maximum of $15,000. The plan is designed to relieve the strain put upon mortgage institutions financing home construction by the decline in realty values, and thus to assist in refinancing sound mortgages and in stimulating construction.

Residential building reached a peak in 1925, gradually declined in the three following years, and dropped sharply from 1929 to 1931. In 257 cities studied by the Bureau of Labor Statistics, 121.8 families in each 10,000 population were provided with housing in 1925, but only 56.0 in 1929 and 27.9 in 1930, while for the first ten months of 1931, according to the F. W. Dodge Corporation's figures, residential contracts awarded represented 13 per cent less floor space than in 1930, indicating a further decline in housing provision.

Whether this decline represents primarily the reduction of a previous surplus of housing, or the creation of a deficit to be made up, is a fruitless statistical discussion. Surpluses and deficits must be measured by comparison with demand. With everything else, demand for housing declines in depression. As President Hoover stated, people "huddle." They take smaller quarters, share homes with other families, or return to the farm. They get along with old houses and apartments just as they get along with old automobiles and clothes. When business recovers and they gain purchasing power their housing needs expand again. Meanwhile the best way to revive residential construction is to reduce its cost. Wage reductions in the building trades are spreading widely, and in nearly all cases have been voluntarily agreed to by the workers. However, as recently as May, the latest date for which the figure is available, the index number of union hourly wage rates in the building trades was at the all-time peak, according to the November Review of the Department of Labor. On the base 1913=100, it was 276.3, compared with 272.8 in 1930 and 261.6 in 1929.

Trade and Industrial Conditions

While building has been slow, the steel industry has gained ground during the past month. From an ingot production a little less than 28 per cent of capacity in October it recovered to 31, 31, and 29 per cent in the first three weeks of November. More impressive

than the extent of this increase is the fact that any gain at all occurred, since the month is usually one of decline. This is evidence that the seasonal recovery which usually comes earlier in the Fall was not wholly lost, but in part only deferred by the unsettlement then ruling; and there are indications in the general business indexes, after adjustment for seasonal influences, that the process of contraction may have ended during the past month. If this proves correct, there is, of course, no assurance that the decline will not be resumed later, but the long duration and steepness of the drop that has already occurred make this appear improbable.

What has given the steel industry its contra-seasonal impetus is the buying of automobile manufacturers preparing their new models. These preparations have gone forward more slowly than had been hoped, but it is clear that December will witness a substantial gain in output. Meanwhile sales plus exports have continued ahead of production, reducing dealers' stocks.

The so-called light industries are running more slowly, their decline being largely seasonal. The retail trade which these industries supply, however, shows some improvement. The Fall increase in department store sales over the very low levels reached in August and September has been somewhat more than seasonal, and the decline in dollar sales under 1930 figures, which for October was 15 per cent, is accounted for by the lower price level. In New York City, department store sales in the first half of November are estimated at 4.8 per cent less than a year ago, whereas the decline in their prices, since January 1 only, has been 14 per cent, according to the Fairchild index. Sales of 44 chains in October were 4.65 per cent less than last year, in dollars, indicating that they moved more goods. The trend toward lower prices for retail merchandise, including the well-known branded lines, continues marked. Reductions on linoleum were a feature of the month, and Spring shoe lines recently opened are off 5 to 15 per cent.

The Advance in Wheat Prices

The advance in wheat prices to which we have referred has its basis in the reduction this year in the available world supplies of wheat and rye, a bread grain practically interchangeable with wheat in many countries. After years of endeavoring to lift wheat prices by political agencies, marketing control, government buying, and similar means, not only in the United States but in many other wheat producing countries, a demonstration is afforded of what really will improve the situation; namely, adjustment of the supply to correspond with reasonable world demands. This adjustment will always be made eventually by farmers acting in their own self-interest, and is only delayed by interferences making it in their interest to keep on growing more wheat than is being consumed.

When the European countries, and particularly Russia, came back to normal wheat production in the years after the war, they found their place partly pre-empted by the development of new wheat growing areas in Canada, the United States, and the Southern Hemisphere. The increase in world wheat acreage was a steady one, reaching the peak in 1930, when a world total of 251,000,000 acres was planted (Russia and China excluded). Beginning with 1925, a surplus of wheat above consumption was produced each year until the current one, the carryover of course increasing each year.

As a result the trend of wheat prices was downward after the season of 1924-25, but various stays in the form of price control were applied to the decline, and as we have said the climax of planting did not occur until 1930. For the current year, the acreage planted outside of Russia and China was decreased about 5 per cent, and although the curtailment seems small it lopped off all the increase that had occurred since 1927. The season being none too favorable in some areas, the world production dropped by 100-150 million bushels, without allowance for the reduction believed to have occurred in the Russian crop. This decrease in production offsets the increase of about 80,000,000 bushels in the countable carryover into the present season, and leaves the world supply smaller than last year by perhaps 100,000,000 bushels, all the decrease and more being in the exporting countries.

While the crops of the European importing countries are larger there is much complaint of their quality, and their rye crop is estimated to be 140,000,000 bushels smaller than in 1930, the total supply of wheat and rye being 100,000,000 less. The European potato crops are 115,000,000 bushels smaller. These figures indicate a larger need for wheat in Europe than a year ago, and the world prospects for the current season may be estimated as follows:

Estimate of World Wheat Position
(In millions of bushels)

	1929-30	1930-31	1931-32
Production:			
Exporting Countries	2,105	2,517	2,316
Importing Countries	1,337	1,190	1,270
	3,442	3,707	3,586
Exportable Supplies (on July 1)			
Countries outside of U.S.S.R.	1,141	1,310	1,245
U.S.S.R.	7	108	75
	1,148	1,418	1,320
World Imports	623	815	860
Carry-Over	525	603	460

Despite small exports from the United States, world shipments of wheat between July 1 and November 1 were the largest in ten years. The supply available for export and carryover in leading countries on that date, exclusive of Russia, was over 50,000,000 bushels less than last year, as follows:

	Nov. 1, 1929	Nov. 1, 1930	Nov. 1, 1931
	(In millions of bushels)		
U. S.	377	374	403
Canada	256	289	236
Argentina	123	173	164
Australia	96	187	142
Danube countries	53	44	68
Total	905	1,067	1,013

Russian Uncertainties

Russia is the uncertain element in the wheat situation. What is the size of her crop, and what her exports will be, are secrets still hidden, perhaps from the Soviet government itself. The reports reaching this country state definitely that the Spring wheat crop was small, and that the total yield was less than last year despite the enlarged acreage; that difficulties in collecting wheat from the farms and in transporting the crop have been acute; that the Fall planting has fallen behind the program, due to the inability of the Russians to use their machinery efficiently, and that the acreage is likely to be less than last year.

With these reports the known facts are in accord. Exports from Russia this season ran ahead of last season until September 26. Since then they have dropped behind, as indicated by the following figures of Black Sea shipments:

	1931	1930
July 1 to Sept. 26	39,710,000	14,900,000
Sept. 26 to Nov. 7	18,870,000	27,300,000
Total	58,580,000	42,200,000

The International Institute of Agriculture estimates Russia's exports this season at 75,000,000 bushels, compared with 93,000,000 in 1930. If this is correct she had less than 20,000,000 bu. left to ship after November 7. Grain procurings during October, it is reported by the Department of Agriculture, were only 52 per cent of the monthly plan. However, up to November 1 they had exceeded the corresponding total last year by 3.4 per cent, reflecting, as did the early increase in exports, the good Winter wheat crops of the Ukraine.

Statements that Russia is relaxing her strict rationing of food consumption have appeared in the press from time to time. But Soviet publications indicate that efforts to increase the domestic food supply are centered on more diversified elements of diet. The purpose of the wheat program is principally to raise more for export. Russia's foreign trade is mostly a process of barter; her credit being limited, she must ship out goods to get goods, and as she desperately needs to import she must export also. This is a fundamental that should not be overlooked in evaluating the rumors that Russia is or is not out of the export market. In the semi-arid areas that she has opened to wheat cultivation she faces many difficulties in growing grain, and in collecting and shipping it after it is grown. There is no finally reliable indication yet as to which of these factors sets her policy at present.

General Commodity Prices

In the past seven years the grains have accounted for 12.5 per cent of the aggregate farm income of the United States, cattle, hogs and sheep for 23.4 per cent, dairy products for 16.4 per cent, cotton and cottonseed for 12.3 per cent, and poultry and eggs for 9.9 per cent; vegetables and fruits and nuts account for the remainder. Prices of many farm products have recovered in fair degree from the lowest levels of the depression, as indicated by the following quotations:

	Low for 1931	Nov. 25, 1931
Wheat, Dec., Chi., bu.	44.63c	54.38c
Corn, Dec., Chi., bu.	32.88	39.75
Oats, Dec., Chi., bu.	20.25	25.25
Rye, Dec., Chi., bu.	35.00	45.75
Lard, Dec., Chi., lb.	5.65	6.07
Butter, Creamery Ex., N. Y., lb.	22.25	31.00
Hogs, average heavy, Chi., lb.	4.45	4.47
Steers, average good, Chi., lb.	6.71	9.88
Lambs, lb.	5.25	5.60
Cotton, spot, New York, lb.	5.50	6.20

The helpful effects of these recoveries in strengthening business morale, in relieving financial pressure upon farmers and their banks, are great, though their practical results may perhaps be overestimated in view of the long path that must be retraced in re-establishing the farmers' purchasing power. For October, according to the Department of Agriculture, the price of farm products was only 68 per cent of the pre-war average while the prices paid by farmers for commodities bought were 126 per cent. The ratio of prices received to prices paid was therefore only 54, which contrasts with 89 in 1929 and 90 in 1928.

For commodity prices as a whole, the index numbers have shown some recovery and an encouraging resistance to the subsequent reaction. The strength that produced their rise in the early part of the month was limited mostly to the grains, silver, whose situation is the subject of a subsequent article, the vegetable oils and some other foods, and to petroleum. Following the action last Summer by the Governors of Oklahoma and Texas in invoking martial law to check oil production, a desperate remedy for a desperate situation, the price of Mid-Continent crude has recovered gradually from 20 cents to 85 cents a barrel. In East Texas, the allowable output

has been reduced by order of the Governor, enforced by the militia, to 125 barrels per well per day. More helpful than anything else, drilling is under strict regulation.

The rise in prices of these staples is evidence that when the fundamental remedy of adjustment of supply to demand is applied the situation will improve. The commodities in which the price drop seems to have been halted are those in which equilibrium in the statistical position has been at least partially restored. Other devices are not effective. There is much pessimism as to commodity prices, but the way out is indicated to the producers; and there is good reason to expect some rise in the general price level when business recovery sets in and credit and currency once more circulate with their normal rapidity.

Money and Banking

The outstanding influence upon the money markets during the month has been the reversal of the gold movement. When the drain on the gold supply of the United States came to an end on October 30 the net loss totaled $737,000,000. Thereafter exports stopped suddenly, and from that date to November 25 only $4,600,000 was shipped abroad. In the same period $55,700,000 of gold previously earmarked for foreign account was released back to this country, and $70,800,000 was imported, a net gain of $121,000,000. The bulk of the imports, or $56,000,000, came from Japan, making a total of $79,000,000 received from that country in two months. This movement is not a special one of any kind, but represents a normal settlement of Japan's balances, of the kind which has sent gold here during the past two years from all our debtor countries.

As a result of this gain in gold, of the decreases in money in circulation during the middle of the month, which we noted earlier, and of purchases of bills for foreign account out of funds which had been idle in the Reserve Banks, money rates have been somewhat easier. The asked rate on bank acceptances of 90 days' maturity, which stood at 3¼ per cent at the end of October, was reduced three times during the month, to 2⅞, followed by an advance to 3. Commercial paper declined from 4 to 3¾ for best names. Time loans on collateral eased slightly, and call money has been in ample supply at 2½ per cent on the Stock Exchange, and at concessions down to 2 per cent outside.

The increased Federal Reserve Bank credit called into use by the loss of gold and the rise in circulation in October has been retired as rapidly as it was no longer needed. During the four weeks ended November 25 the amount outstanding was reduced by $270,000,000; bills discounted declined $31,000,000 and bills purchased dropped $245,000,000. The ratio of reserves to note and deposit liabilities rose from 59.9 to 65.0 per cent.

The volume of currency in circulation, on which attention continues to be focussed, may be expected to rise from the present time until the first of next year. Such an increase is entirely seasonal, reflecting the growth of retail trade, and will not signify hoarding unless it is of exceptional proportions.

The Contraction of Bank Credit

A factor in this rapid retirement of Reserve Bank credit has been the reduced reserve requirements of the member banks resulting from the decline in their deposits, which at the last statement date of the reporting member banks, November 18, had been unchecked for seven weeks. This decline is in some degree a reflection of currency hoarding, but to a greater extent results from the liquidation of loans incident to dull business and declining security markets. During the seven weeks mentioned secured loans of these banks were reduced $457,000,000, and their "other" or commercial loans $292,000,000. Their investments in United States government securities declined $159,000,000, and in other securities $197,000,000. The sum of these items is a total reduction in the outstanding credit of these banks of $1,105,000,000.

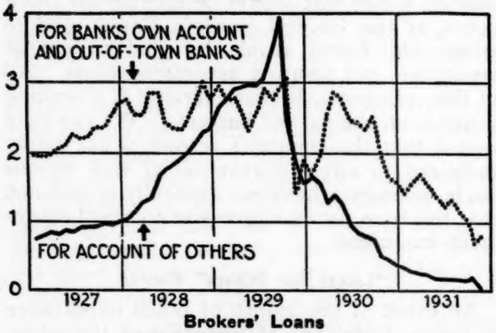
The decline in loans and deposits is both a cause and effect of depression. It is a part of the vicious circle of deflation. The decline of prices and business, and pressure on the banks in many localities by their depositors, forces them to reduce their loans on all but the most liquid paper, and this tends to force more decline in prices and more liquidation of loans. Meantime, prime borrowers presenting paper that would be eligible for rediscount at the Federal Reserve Banks, and to whom the banks would be glad to extend credit, are not wanting accommodations. All of this, of course, is characteristic of a waiting attitude on the part of business. We can only repeat that the country's resources are amply sufficient to effect a reversal of this vicious circle, whenever business generally is satisfied that the time for an aggressive forward movement has come.

"Loans for Others" Barred

An event of the month of much importance to future historians of finance was the adoption by the New York Clearing House Association of an amendment to its constitution prohibiting member banks from placing brokers' loans for account of non-banking interests,—the so-called "loans for others" which played a major part in financing the stock market speculation of 1928-29. In accordance

with the amendment, such demand loans outstanding were called on November 16, and the practice of lending funds of individuals and corporations to brokers and security dealers was terminated insofar as the New York City banks have it in their power to do so.

It is significant of the damaging experience that the financial community has had as a result of these loans that the action of the banks in barring them has been generally commended. Three and four years ago, when bankers took occasion to criticize the practice, and to point out some of the dangers in it, their apprehensions were but little regarded, and were even considered by some a form of professional jealousy arising from a desire of banks to reserve the brokers' loan market for themselves. If there was such desire, the reasons for it were good ones, and far from selfish. When after reducing discount rates and easing the credit situation through open-market operations in the late Summer and Autumn of 1927, the Reserve Banks in the following Winter and Spring reversed their policies, the logic of events indicated that the growing speculation in securities would be brought quickly under control before harm was caused. That this effort at control failed was due in great part to the increase of these "loans for others," attracted by the premiums which the stock market was willing to pay for money. The accompanying chart presents the course of these loans as reported by the New York City banks from the beginning of 1927 on, and shows how rapid was their rise during 1928, leading to their high point of nearly $4,000,000,000 in October, 1929. Thence they were reduced to $162,000,000 in the week preceding the Clearing House's prohibition. During this period the brokers' loans made by banks followed a much more even course.



Brokers' Loans
(In billions of dollars)

The evil consequences of these "loans for others" arose from the fact that they diverted money from the banking system, which is a reservoir supplying all business, to a reservoir supplying only the securities markets. The creation of such a special reservoir of such magnitude nullified all attempts to restrain the excess of speculation which was threatening business. It weakened the authority as well as the resources of the Federal Reserve System, and threw the administration and distribution of credit into a state of semi-anarchy. There can be no doubt that those who made these loans for the purpose of earning a higher interest rate than was commercially obtainable have lost their gains many times over through the disastrous after-effects of the speculation they mistakenly financed.

It is also pertinent to note, in turning the page upon this chapter of history, that this "other" money proved to be timid money, justifying the worst fears of bankers in that respect. When the break came in October 1929, the multitude of lenders in the call money market acted without cooperation, looking only to the safety of their individual interests. In the week ended October 30, 1929, they withdrew $1,360,000,000, more than a third of their outstanding loans, and the out-of-town banks withdrew another $725,000,000. The New York banks overnight were asked by the borrowers to replace a great part of these funds, which they did, acting in cooperation, by increasing their own loans approximately a billion dollars. The call money renewal rate remained undisturbed at 6 per cent. The emergency was thus met. But action of the banks for the purpose of assuring against the recurrence of any such condition and its inevitable crisis is undoubtedly wise. It has been delayed until this time only in order that the shift of funds might be made with a minimum of disturbance.

The Bond Market

Bond prices in the early part of November made a good recovery from the extreme lows reached at the end of October, all classes and ratings participating in the gains. The rise, however, proved short-lived, and in the second half of the month the trend was again downward. The market has been a thin one, void of either acute selling pressure or vigorous buying; and its action has reflected general uncertainty and poor earnings reports more than any other factors.

In the decline railway bonds, particularly the second-grade issues, have been leaders. Further steps have been taken in the effort to obtain relief for the railway situation, but without tangible result thus far. During the month a request was made to the unionized employes, through the Railway Labor Executives' Association, for their assent to a 10 per cent emergency wage reduction. It was rejected, however, by the chairman of the association, the rejection being the signal for a decline in rail bond prices which affected

other groups. A meeting of about 1,500 local chairmen of the brotherhoods to be held in Chicago December 8 will consider the request. If they likewise reject it the roads feel that they have no alternative but to order cuts made under the machinery set forth in the Transportation Act, which involves recourse to boards of mediation and arbitration in case agreement cannot otherwise be reached.

It has become increasingly clear, as the Autumn has come and almost gone without traffic increase or gain in earnings, that reduction of railway wages is inescapable. The petition for rate increases made by the roads last June reflected the desire of the executives to avoid this necessity if possible, but it is no longer possible. Many roads are not earning their fixed charges, and some not their operating costs. The savings of the country are more generally invested in railway bonds than in any other bonds except those of the United States Government, and any general impairment of their security through indefinite continuation of present conditions would have serious consequences to society. There is reason to think that the country generally is taking this view.

Meanwhile the question of relief through freight rate increases has been passed back to the Interstate Commerce Commission for decision. The railway executives have made their reply to the Commission's proposal to allow certain increases, contingent upon the pooling of the proceeds for the benefit of the roads not earning their fixed charges. The reply sets forth a plan for treating payments out of the fund to such roads as loans instead of gifts. The response of the I. C. C. to this plan, and the fate of the wage negotiations, will doubtless be major influences on bond prices during the coming weeks.

The relaxation of the credit strain has helped prices of United States Government bonds, which on the long-term issues are 2 to 4 points above the lows. On December 15 the Treasury must meet the maturity of notes and certificates totaling approximately a billion dollars. It concurrently faces the problem of financing the Federal deficit. With demand for bonds as restricted as it is now the supply becomes the important factor in setting the price, and pending announcement of forthcoming offerings and the extent of possible Congressional demands upon the Treasury the general disposition is to mark time.

A sharp rise in Argentine bonds, followed by a decline nearly as severe, was the feature of the market for foreign issues. The advance was associated with the rise of wheat, but had also as a basis the progress that Argentina has achieved toward balancing her payments, through reduction of imports and increase of exports. The reaction which followed leaves these bonds considerably above their lows.

Decline of New Issues

November has been another month of virtual stagnation so far as new bond issues are concerned. The total offered through the 27th of the month was only $68,500,000, the largest share being in municipal bonds although the largest single issue was in the railroad class, $12,000,000 Cincinnati Union Terminal 5s.

Total new capital issues in October and November, covering new capital and refunding, bonds, notes and stocks, were as follows, in millions of dollars:

	1931	1930	1929	1928	1927
October	$ 45	$ 459	$ 881	$ 800	$1,034
November	69*	267	298	970	773
11 Months	3,816	7,294	10,942	8,816	8,893

* Throu; h the 27th.

Unless there is a material increase in new financing in December the total for the year 1931 will be the lowest of any year as far back as 1919 at least, which is the earliest year covered by the Financial Chronicle in these tabulations.

This decline in new financing accentuates as well as reflects the business depression, illustrating how the normal flow of savings into productive use has stopped, and making the problem of refinancing obligations that fall due a very serious one unless the credit of the borrower is exceptionally high. It of course has its favorable side in that outstanding issues are being thoroughly "digested," passing into stronger hands at lower prices during these months of liquidation.

Governmental Finance

Receipts of the United States Treasury general fund for the first five months of the current fiscal year, extending from July 1 through November 23, amounted to approximately $782,000,000, while expenditures during the same period totaled $1,591,000,000, resulting in a deficit to date of $810,000,000. Receipts were 25 per cent below those of the corresponding period of last year and at a rate which, if continued, would give a total for the complete fiscal year ending June 30, 1932, around $2,500,000,000. Expenditures, however, have been 20 per cent larger than last year and at the rate of $5,000,000,000 for the full year, thus indicating a deficit of over $2,000,000,000. For the previous fiscal year, ended June 30, 1931, receipts totaled $3,317,000,000, expenditures $4,220,000,000 and the deficit $903,000,000. A surplus of receipts over expenditures was shown in each of the eleven preceding years back to 1920.

The principal factor in the decline in revenues during the past two years has been the

falling off in income tax receipts from corporations and individuals, which have been the chief source of government revenue but are subject to wide fluctuation in accordance with the changing volume of business and personal income. Practically all other receipts have also decreased materially, including internal revenue taxes, customs receipts, payments by foreign governments on account of war debts and miscellaneous income.

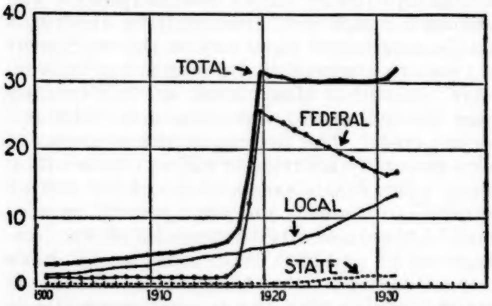
Ordinary expenditures of the government have been on a rising scale during recent years, in addition to which a number of extraordinary appropriations have been made. These include appropriations as follows: to the Federal Farm Board for operations under the Agricultural Marketing Act, to the Department of Agriculture for largely additional outlays for Federal aid highway construction and for emergency relief in drought areas, to the Veterans' Bureau for liberalized provisions for military and naval compensation to war veterans, to the Adjusted Service Certificate Fund for advance appropriations that would ordinarily have been made in subsequent years, to the War Department for cost of construction activities in connection with rivers and harbors, flood control, the Army housing program and increased outlay for the Air Corps, also speeding up of Federal building program. These and other special appropriations, combined with the severe decline in revenues, have brought about what promises to be the largest deficit incurred by this or any country in any peace-time year.

Steps to restore a balanced budget have already been taken by the reduction in expenditures, now estimated at $350,000,000 below the original requests, throughout the various departments wherever economies may be effected without seriously impairing the usefulness of essential government services, and by a program for increase of revenues that is being prepared for consideration by Congress. A prompt and very substantial increase in taxes will be needed. Not even the United States Government can afford to ignore indefinitely an increasing disproportion of expenditure over income.

Rise in Local Government Debt

The burden of an increase in taxes at the present time would be far less formidable were the financial situation of the Federal Government the only problem to be considered, but unfortunately the expenditures and public debts of the state, municipal and local subdivisions have been expanding at a rapid rate during recent years and in many instances have reached a point where the sum-total of various local taxes has become an excessively heavy burden upon business and individual taxpayers.

In the chart below, the respective amounts of outstanding Federal, state and local government debt are shown from 1900 to date, taken from official Treasury Department reports and data compiled by the Bureau of the Census, with the figures for 1931 covering state and local debt estimated on the basis of the rate of increase prevailing up to 1930. In the case of some of the earlier years in which figures were not compiled, the points on the chart have been interpolated by the straight line method.



Public Debt of Federal, State and Local Governments
(In billions of dollars)

During the period from 1900 to 1916 the gross debt of the Federal Government remained practically stationary at around $1,200,000,000, while state debt was doubled and local debt tripled. Borrowings for war purposes increased the Federal debt to a peak in August, 1919, and to $25,482,000,000 at the end of the 1919 fiscal year. Since that date a continuous series of eleven annual reductions aggregating $9,297,000,000 reduced the outstanding total to $16,185,000,000 by 1930. During the same period, however, an increase in debts of state and local governments, principally the latter, of more than $9,000,000,000 offset the reduction in Federal debt so that practically no reduction whatever was made in total government debt. This year both Federal and local debt are being increased and their combined total is now in the neighborhood of $32,000,000,000, which is higher than ever before. In the face of this showing there seems little basis for the claim, often heard, that the rate of retirement of the Federal debt has been too rapid.

Difficulties in Municipal Finance

It is not our intention to argue the question as to what constitutes justifiable public improvement. Considering solely the financial side, it is found that in many, though by no means all, cities and towns the tax rates and property valuations have alternately been raised to a point where property owners who have been affected by unemployment, reduced incomes, non-collection of rents, vacant space

and a slump in realty values have been unable to meet their taxes or mortgage interest, or both. This year there has been a marked increase in forced sales to satisfy unpaid taxes and it is common knowledge that some of these transfers have been made at less than the assessed valuations for tax purposes, which average only about 75 per cent of supposed actual valuations.

Meanwhile the high expenses of running the government have gone on undiminished in many cases, and in some cities have even been increased. Where the amount of tax assessments in arrears reaches substantial proportions it increases the difficulties of balancing municipal budgets, and often makes necessary an increase in outstanding debt to bridge a deficit. Some cities are already so near the statutory debt limit fixed by their state constitution that they have been unable to float additional bond issues and have been forced to seek temporary loans from local banks against future tax collections. A condition where such expedients are needed to provide for the payment of salaries to policemen, firemen, school teachers, nurses and other city employes is by no means so rare as might be imagined, and reflects no credit on the administrations responsible for such a state of affairs.

No sweeping criticism of municipal finances is warranted, for some large cities have had wise and efficient administration and are in good financial condition. A few have actually reduced their expenses during the past year or two. Among these might be mentioned Detroit, whose Bureau of Government Research organized some years ago has been a valuable aid toward improving the efficiency of city administrations not only in Detroit but throughout the country. Whenever a large bonded indebtedness has been built up, however, it is particularly difficult to cut expenditures for the reason that a large part of the total budget represents fixed charges for interest and sinking funds for long-term issues. Moreover, appropriations made by some cities for unemployment relief have been an added unavoidable item in their budgets this year.

In a few cities, however, in the face of a financial situation that is admittedly critical and growing worse, the administrations have continued to spend money freely, if not lavishly, with apparently complete disregard of possible injury to the credit standing of the municipalities concerned.

It would be in the public interest for the responsible citizens of each community to realize, before it is too late, that excessive government expenditures and indebtedness not only add to their tax burden but gravely affect the credit standing of their communities and the terms on which future bond issues can be sold. Once destroyed, a good credit rating may take years to rebuild and in the meantime the cost of financing may be greatly increased. In most states the bonds of any municipality that has defaulted become legally ineligible for investment by trustees for an extended period.

Until a short time ago, the municipal bond market gave relatively little attention to the details of municipal finance, and operated a good deal on the theory that the taxing power of any municipality was ample and that its bonds were safe, provided their legality had been passed on by approved counsel. Marketability was the variable factor, and this depended on the importance of the borrower and the extent to which its securities were known among investors.

Today things are different. Buyers of municipal bonds are analyzing the reports of receipts, disbursements, bonded debt, property valuations and other details in the same way that they analyze the statements of business corporations. If necessary, they may even send their representatives to make a special study on the ground. This change is all to the good, since it will improve the character of municipal offerings and avoid the further extension of credit to cities and towns that have shown indifference to sound financial policies.

The Urgent Need for Economy

The foregoing facts serve to emphasize the need for the most rigid economy in fiscal affairs. In times like the present it is inevitable that all sorts of proposals will be brought forward contemplating various kinds of relief work and generally involving an increase of government expenditures or pledging of public credit. Many of these proposals are of hysterical character, and receive a hearing only because the public is in a frame of mind to be receptive to almost anything that gives some promise of temporary relief even at the risk of making things worse in the end. In view of the already excessive burden of public debt and taxation it is of first importance that all projects calling for further expenditures of public funds should be subjected to most critical analysis. Needless to say this should be the case with current expenditures as well.

Unemployment relief, where beyond the capacity of private contributions to meet the situation, will undoubtedly impose additional burdens on many municipal budgets this winter, and this is a legitimate call, for our people who are without work must be taken care of. Heretofore, however, the administration of relief has been characterized by much waste, and there is unquestionably room for economy in the organization of this work. In general,

the principle has been accepted in this country that unemployment relief is a matter for local rather than Federal treatment. Where funds are raised and distributed locally there is a natural safeguard against extravagance, whereas experience shows that expenditures made by a central authority for the benefit of local communities are apt to be swollen by the natural desire of each community to get all it can.

Borrowing to Restore Prosperity

Of the various schemes proposed to relieve the depression, the favorite perhaps is that the government should float a large bond issue to finance a program of public works and improvements. To the extent that such improvements are really needed and do not anticipate the future too far ahead, there will be no quarrel with such a program. The principle that public building should be so distributed as to iron out building peaks and depressions so far as possible is one that has general endorsement. Public construction, however, purely for the sake of making work is an altogether different proposition. It may be argued that the building of new roads, school houses, and the like adds to the wealth of the community, but the same might be said of the huge public improvements program of the past decade, the cost of which is now weighing so heavily upon the taxpayers. The plain truth is that such expenditures add also to the debt of the community. What can be said of the wisdom of a relief program which proposes to add new taxes and new debts to a community already overburdened with taxation and debts?

Nor is this all. Excessive issues of public securities are damaging to the public credit, causing declines in outstanding issues and loss to investors, which in the case of banks and insurance companies often has serious complications. They absorb funds from the investment market which might better be left available against the time when legitimate business demands will increase. And last but not least, the expenditure of these funds on unneeded projects tends to delay inevitable readjustments in prices and wages, and thus to prolong the depression.

The German Situation

The most important situation in Europe, of course, is the German situation, including as it does the reparations moratorium, the standstill agreement upon short-term credits, the maintenance of the gold standard in Germany and the general state of prosperity in the country which normally has the second largest volume of trade in the world.

France, being the largest creditor on reparations account, properly has a leading place in negotiations upon that subject, and since the visit of the French Premier to the United States, conversations between the French and German Governments have been continuous. The French have not refused to consider the urgent arguments for a reduction of the payments but have tenaciously held that the Young Plan makes provision for a possible reduction, and that the Young Plan must be held inviolate as a duly executed treaty between nations.

The relief contemplated in the Young Plan in case the full terms of the treaty should prove to be impracticable was provided by dividing the payments for the full term into two classes, called "postponable" and "non-postponable." The aggregate is an average of approximately 2,050,000,000 marks per year for thirty-seven years and 1,530,000,000 marks for an additional twenty-two years. The "non-postponable" payments consist of 660,000,000 gold marks (approximately $158,000,000), to be made annually over a period of thirty-seven years. This amount corresponds to the annual interest and amortization charges upon the reparations mortgage which was placed on the German railways under the Dawes Plan. The Young Plan released this mortgage but provided that an annual tax producing an equivalent amount should be paid by the railways for reparations purposes. The sum, 660,000,000 marks, compares with 2,500,000,000 marks, the total sum of reparations paid in the fifth year of the Dawes Plan.

Germany is in an exceedingly pessimistic mood at the present time, although possibly it is not so much worse off than other countries as it may think, and does not see how it can pay any reparations. However, the German Government has adopted the proposal of the French and approached the subject by way of the provision of the Young Plan. A formal note has been addressed to the Bank for International Settlements, setting forth, in the language of the Plan, that "Germany's exchange and economic life may be seriously endangered by further transfer in part or in full of the postponable portion of the annuities."

This declaration having been made, the Bank has proceeded, as the Young Plan provides, to create a committee to examine into the situation. If, however, the findings of the committee support the German contention the result will be only a postponement of the postponable class of payments instead of complete relinquishment.

Germany, of course, seeks a final reduction of the payments, on the ground that conditions beyond her control have affected her ability to carry out the terms which she agreed to under protest and in a sense under duress. It can hardly be maintained that either of the

reparations agreements was entered into by Germany through free bargaining. The Dawes Plan succeeded one that was far more severe, and the principal argument for the Young Plan was that it was a substitute for the Dawes Plan with a smaller sum of payments.

The German Government sets forth that the formal statement required by the Young Plan does not do justice to the situation, and asks that the advisory committee "shall examine the problem in its entirety," taking account of all Germany's obligations abroad as well as the reparations payments, and especially the German short-term indebtedness which under the standstill agreement will be coming due in February.

It appears, therefore, that unless reports that have been coming out of Paris, and which are supported to some extent by the Paris press, are wholly misleading, the forthcoming negotiations will not be kept within the confines of the Young agreement. The French are not an impractical people; they know the calamity that has come upon the world since the Young Plan was made and they are familiar with the state of German public finance, also the state of German industry. They know how vital is a complete settlement of the reparations problem to Europe and to the world and they know that a settlement rests with them.

Subordinate Phases of the Situation

There are features of the German financial situation which may be agreed to be open to criticism but which almost certainly have been given undue importance in relation to the entire problem. No doubt some of the loans procured by municipalities had better not have been made, but Germany has the weaknesses of a democracy. Its governing powers are selected by popular vote and a disposition to spend money freely on public works is characteristic of all democracies. We know something about that in the United States. Moreover, it is true of some of the steadiest populations in Europe. The expenditures of the municipalities of Holland have increased in recent years at a rate which has caused much unfavorable comment in that country, and brought some of the leading cities into difficulties. It need not be supposed that Germany could be wholly free from the mania of spending which has raged everywhere else. Doubtless the greater part of the foreign loans obtained by Germany were expended in ways which increased the productivity of the country and its ability to pay reparations; moreover, it is certain that the reparations payments could not have been transferred out of Germany without the foreign credits created by loans. These considerations cannot be left out of the account.

The Short-Term Debts

A meeting of representatives of the banks holding the short-term German debt is about to be held in Berlin. The situation regarding these debts became critical last June, when alarm regarding the general credit situation spread through central Europe. It was evident that Germany could not pay off at once in gold or foreign exchange all of the foreign loans that she was owing, although this did not mean bankruptcy in the sense of not having sound assets in excess of liabilities. As a result of a meeting of creditors extensions have been agreed to, the one now in force expiring February 29, 1932.

As the moratorium year upon reparations advances the holders of short-term German debt are naturally anxious regarding the policy to be pursued by the governments interested in reparations. Much of the public discussion has assumed a conflict between reparations payments and short debt, but this is due in part to the fact that the short debt is not all of the same character and to absence of knowledge that much of the short debt is indispensable to German industry, German trade and the payment of any reparations.

If any lesson has been taught by past experience it is that reparations payments are dependent upon the activity of German industry and trade and upon a sound economic structure in the country. The first step in the rehabilitation of Germany was the provision of a sound monetary system, for which the basis was provided largely by her creditors. However, a monetary system cannot of itself assure an adequate supply of capital and Germany at no time since the war, or even before the war, has had a home supply of working capital equal to the requirements of her industries when in active operation.

It is evident that German manufacturers and traders must produce and market the surplus wealth from which foreign payments are made, and they must have a liquid fund of capital with which to work.

The German industrial system is constantly in debt for its current needs and short credits abroad are absolutely essential. The foreign financial centers which specialize in commercial bills meet these needs in the most satisfactory manner. The operations of these foreign commercial lenders are in no way disadvantageous to the long-term creditors of Germany. Their services are a part of the equipment of the German economy.

It is obvious, however, that the operations of the foreign lenders must be free and voluntary. They must carry on their business in their own way, for they can carry it on in no other way. The funds at their command can be safely used only in these short-term self-liquidating credits. To say that such credits

must be made secondary to long-term loans or converted into long-term loans would mean that this service of short-term funds would no longer be available to Germany. The effect would be that of crippling German trade, to the injury of all of Germany's creditors. It would be as though the creditors of an individual concern would deny it the use of working capital to handle its affairs effectively.

The finding of a way to reassure the short-term lenders of commercial credits is one of the most important problems confronting Germany's political creditors, for the payment of any political debts depends upon the necessary trade facilities for German industry. The question of priority does not properly arise.

Internal Conditions

The state of German industry and internal trade continues most depressing. In part, of course, this is due to the general world conditions, but in addition German industry has been particularly hard hit by the confidence crisis and the acute shortage of credit resulting therefrom. Unemployment returns for the middle of November indicate a total of nearly 5 millions out of work, compared with 3¼ millions a year ago, and further increases are feared during the Winter. The cost of caring for these people under unemployment insurance and other relief plans presents a serious problem at a time when the public revenues, despite the high rates of taxation, are so much reduced. Many of the municipalities are in financial difficulty, and obliged to look to the central government for help. Thus, pressed from all sides, the Government of the Reich has been forced to institute drastic and far reaching economies, affecting not only practically all branches of public finance, but extending into the field of private enterprise as well. By these measures it is hoped that the finances of the Government can be maintained on a sound basis.

The disappointments and hardships which the German people are undergoing inevitably play into the hands of the political extremists and tend to weaken the authority of the moderate parties supporting Chancellor Bruening. When people are in trouble it is a natural instinct, not confined to the German people, to seek radical remedies, and this is all the more likely to be the case where the troubles can be ascribed to outside "oppression." At the October reassembling of the Reichstag, Chancellor Bruening won a victory when he succeeded in obtaining the defeat of a no-confidence motion, and of other resolutions calling for the dissolution of the Reichstag, new elections, and revocation of the Government's various emergency measures. Finally, after a four day session, the Reichstag voted to adjourn until February 23. Thus, the Bruening Government continues to survive, and will have opportunity to develop without Parliamentary interference in its program for the Winter. Nevertheless, there are unmistakable evidences of a growth in radical sentiment in local elections and in such incidents as the recent action of the Prussian Diet, representing about two-thirds of the nation, in passing with no dissenting votes and only ninety-two abstentions from voting a motion requesting the Reich Government immediately to begin negotiations for revision of the Young Plan with a view to "complete cessation of any kind of tribute payments."

Foreign Trade and Exchange Position

An outstanding feature of the German situation, and one of the most hopeful developments from the German standpoint, is the huge surplus of exports over imports being rolled up in the current year. During the months of July, August, September and October, the export surpluses (exclusive of reparations payments in kind) totaled $55,000,000, $76,000,000, $87,000,000 and $91,000,000 each successive figure being a new high record. For the ten months ended October, the surplus of exports amounted to $479,000,000, compared with $150,000,000 in the corresponding period of last year, and an import balance of $154,000,000 in the corresponding period of 1929. Prior to the war Germany invariably reported an excess of imports.

Analysis of the trade figures shows this remarkable performance to be due principally to a shrinkage in imports, which were down 36 per cent for the ten months as compared with a year ago, while exports were down only 19 per cent.

The creation of these huge export surpluses is partly the result of the depression which has curtailed the need to buy raw materials, and partly the consequence of Germany's heavy foreign obligations which force her to restrict imports to the minimum and expand exports to the maximum. Moreover, in the last few months, the credit crisis has been a special factor tending to check imports and promote exports. In the long run a replenishment of raw material supplies is inevitable, hence it is not to be assumed offhand that the present large trade balances can be continued indefinitely. Nevertheless, these trade balances represent a credit item of first importance in the current balance sheet of Germany's international payments.

In view of the large monthly export surplus, and postponement of reparations payments, it might be supposed that the Reichsbank would be having no difficulty in meeting calls for foreign exchange. In the period from July 1 to October 31 the export surplus amounted to $309,000,000. Nevertheless, the

Reichsbank has lost reserve continuously and the ratio of reserve to liabilities has reached a succession of new low points, the last being 26.7 on November 15. Following is a table which shows the changes in the Reichsbank position since the beginning of September:

Reichsbank Gold Holdings and Foreign Exchange
(In millions of reichsmarks)

	Sept. 7, 1931	Nov. 23, 1931	
Gold Reserve	1,370	1,008	—362
Foreign Exchange	400	168	—232
Total	1,770	1,176	—594
Note Circulation	4,292	4,277	— 15
Ratio—Per cent	41.3	27.8	

No doubt a portion of this loss of exchange reflects a move on the part of German borrowers to repay sterling debts at the depreciated exchange rates. In an interview with the press, Dr. Hans Luther, President of the Reichsbank, ascribed the loss of gold and foreign exchange to three causes, namely an unusually large amount of service charges on foreign loans paid during the period, leakages in the Basle agreement on credits, and the fact that German exporters in order to get business, are being obliged to extend at least five months' credits, while in the case of shipments to Russia payment will not be received until 1933. It is possible also that the decline in legal foreign exchange reserves reflects the shortage of bills on gold standard countries developed in recent months, and it must be remembered that the Reichsbank has holdings of foreign exchange which, although ineligible under the statutes as reserves, yet represent ownership of balances abroad. In addition, the suspicion arises that, notwithstanding the control of foreign exchange instituted by the government, some considerable flight of capital from Germany is taking place. It will be admitted that the task of controlling a flight of capital where conditions conducive to such a flight exist has always proved to be a difficult one. What is needed in the case of Germany is a settlement of her political and financial problems on a basis to establish confidence in Germany's solvency, in which case capital will not only cease to seek flight from the country but will return willingly to it.

Speculation in Silver

The short-lived advance in commodity prices during the past month was featured by a spectacular rise and fall in the price of silver. In the early part of the year, silver prices fluctuated between 26 cents per ounce, the all-time low established in the middle of last February, and 30 cents, at which it was quoted at the beginning of November. From this level silver spot prices in New York advanced within ten days to 37¾ cents per ounce, with October futures moving above 41 cents. An equally rapid decline to below the 30 cent level followed. These fluctuations occurred in New York and London, but the great markets in Asia failed to register any such rise and there was no corresponding advance in the Chinese currencies, which are based upon silver.

It is difficult to evaluate the strength of various forces behind this unusual movement, which appears to have been largely speculative. Undoubtedly the spurt in wheat prices and firmness in various other staple commodities encouraged the buying of silver on the theory that commodity prices in general had touched bottom. The possibility of a conflict between China and Japan, the propaganda in favor of increasing the use of silver as money, and the liberal margin requirements of the National Metal Exchange of New York for dealing in silver were other probable influences.

According to the by-laws of the Exchange, the minimum margin is $500 on each "contract" or trading unit of 25,000 ounces, which at 30 cents per ounce would represent a margin of only 6-2/3 per cent, but it is reported that, as a result of the recent wide fluctuations in price, brokers have raised the requirements to their customers above the stipulated minimum. Dealings during the first ten trading days of November exceeded 55,000,000 ounces, which is several times as large as estimated stocks of silver in the New York market and indicates that a considerable portion of the contracts will be settled on paper and not by actual delivery of the metal.

In the past year the production of new silver declined in line with non-ferrous metals, of which it is a by-product, and world production is expected to be 190-200 million ounces, or 20 per cent below the last year. No large demonetizing operations, such as took place in 1930 in France and Indo-China, have been reported, and it is therefore likely that the total supply of silver, both new and secondary, will be less than two-thirds that of last year's supply, which was 315,000,000 ounces. On the other hand, consumption has also declined substantially and the Chinese absorption, as measured by the exports through the ports of New York and San Francisco, amounted to only 31,000,000 ounces during the first eight months of 1931 against 76,000,000 ounces during the same period last year. Takings by India, which twice this year advanced its tariff on silver, were also considerably less.

Agitation in Behalf of Silver

Many people see in the fall of silver prices a leading cause of the world depression, and argue that the most practicable way of curing the depression is to bring about a rise in silver prices by restoring the metal to a more important place in the monetary systems of the

world. In support of this argument, reference is usually made to the magnitude of the silver using populations, which, counting China and India, include something like half the population of the world. By permitting silver to undergo a great shrinkage, there has been caused, it is said, a corresponding decline in the buying power of these large populations, which has brought on the depression.

It would be well, however, to subject these arguments to analysis. In the first place, it must be remembered that while India uses silver as her principal form of currency, she is not on a silver basis, her currency being held in practically fixed relation to the British pound, which until recently has been a gold currency. Thus the decline in the value of silver bullion has had no more effect upon the purchasing power of the silver rupee than it has had on the purchasing power of the American silver dollar or the silver certificates based thereon. It has, of course, affected the value of silver trinkets and other ornaments hoarded by the Indian population, as it has the value of similar ornaments and plateware in this country, but since these are not usually sold there is no reason to believe that their depreciation has seriously affected the volume of India's purchases in foreign markets.

As to the influence of low silver prices on the purchasing power of China, and hence upon world trade, it is a mistake to assume that because China has about a fifth of the population of the world she exercises a corresponding influence economically. A large part of her population is practically destitute, or consumes nothing but what it produces and is of little importance in world trade. As Sir Arthur Salter, the British economist, has recently pointed out, this 20 per cent of the world's population took prior to the depression but 2½ per cent of the world's exports. Obviously it is an exaggeration to consider fluctuations in this 2½ per cent as a major cause of the depression.

Effect of Fall in Silver on Chinese Trade

Still more convincing evidence that the unfavorable effects of the fall in silver have been grossly exaggerated appear in the statistics of Chinese foreign trade. Were it true that cheap silver has reduced the purchasing power of China as much as has been represented it ought to show in the trade figures. As a matter of fact these show that Chinese imports have fallen off by a percentage not materially greater than that for world trade in general. According to the report of Mr. H. D. Hilliard, Inspector General of Customs of China, the value of Chinese imports in 1930 at the average rates ruling through the year was about $603,000,000, or approximately 26 per cent less than in 1929. At the same time, the total world trade, as estimated by the League of Nations from reports of eighty countries, fell about 24.5 per cent. Unfortunately, comprehensive figures covering Chinese trade for 1931 are not yet available, but the figures of United States trade with China may perhaps be taken as indicative of the trend. These show that during the first nine months of this year the value of our shipments to China was $59,000,000 or 8 per cent less than in the corresponding period of last year, while our exports to the rest of the world aggregated $1,783,000,000, a decrease of about 38 per cent from the corresponding period of last year.

We do not mean to imply by this that the fall in silver has been entirely without effect upon Chinese trade. Unquestionably, it has acted to cut down imports of certain classes of foreign goods, particularly finished goods the gold prices of which have not fallen as rapidly as silver. Following is a table showing the change in value and in volume of a number of leading commodities in our exports to China during the first nine months of 1930 and 1931, but not comprising a complete list of important finished manufactures, the figures for which are not published in detail until some time after the close of the year:

Exports of Merchandise from United States to China, Hong Kong and Kwantung
(In thousands of dollars)

	First Nine Mos.		Per Cent Change	
	1931	1930	Value	Volume
Cotton, raw	$18,634	$12,446	+ 49.7	+ 145.9
Tobacco, bright leaf	9,893	9,213	+ 7.4	+ 35.8
Kerosene	5,388	10,681	— 49.6	— 38.4
Wheat flour	3,935	6,382	— 38.3	— 14.8
Gasoline	1,653	2,562	— 35.5	— 20.9
Lumber, doug. fir	1,445	1,411	+ 2.4	+ 23.1
Tin plate	1,286	1,992	— 35.4	— 27.8
Lubricating oil	1,250	1,578	— 20.8	— 3.6
Wheat	1,297	156	+731.4	+1,894.9
Gas & fuel oil	665	520	+ 27.8	+ 24.9
Milk, cond. & evap.	616	867	— 29.0	— 26.3
Timber, doug. fir	501	551	— 9.1	+ 17.4
Paraffin wax	449	611	— 26.5	— 3.3
Copper, refined	412	742	— 44.5	— 16.1
Cigarettes	254	2,072	— 87.7	— 93.4
Auto tires (casings)	210	324	— 35.2	— 20.9

That Chinese import trade as a whole has not suffered more severely from the effects of cheap silver is apparently due to an increased import of certain raw materials and foodstuffs, stimulated partly by the increased internal trade activity, partly by crop shortages, and partly by the fact that prices of many of these commodities have fallen even more sharply than silver, thus preserving an exchange ratio which has continued favorable to the Chinese. For example, the drop of 48 per cent in silver since the beginning of 1929 has been paralleled by a drop of 70 per cent in cotton, 60 per cent in wheat, and 40 per cent in kerosene. These are all commodities that bulk large in Chinese imports, and doubtless other commodities could be cited where the same thing has occurred.

Cheap Silver a Result not a Cause of Depression

The fact that Chinese imports have held up as well as those of gold using countries is clear evidence that the fall in silver has not been a major cause of the world's economic difficulties. As a matter of fact, we feel that those who argue this way have the cart before the horse, and that it is more correct to look upon low silver prices as the result rather than the cause of world troubles. China and India are the largest factors in the silver market, taking in the years 1924-1929 not far from 200,000,000 ounces per year, or nearly four-fifths of the world's production. Both are now in a disordered state politically and economically. China has been a victim of civil war and banditry which has checked the demand for silver and resulted in huge accumulations at the ports. Similarly, the stagnation in trade in India, and decline of prices of Indian products, have caused a lessened demand for silver for currency, which has been reflected both in smaller imports and in a piling up of silver, unwanted for circulation purposes, in the Indian Treasury. Seeing no prospects for an increased need for this silver commensurate with the large supplies, and feeling a restriction of revenues due to trade depression, the Indian Treasury over a period of several years has melted down and sold approximately 100,000,000 ounces from its silver stores, and this has also had a depressing effect upon the market.

The accumulation of large excess stocks of silver in India is but another illustration of the derangements caused by the war. During and immediately after the war the demand for Indian products was so heavy as to require the shipments of large amounts of gold and silver in settlement of trade balances. These demands grew so insistent as to exhaust open market supplies of silver, and in 1918, London, in order to protect its gold reserves, made an arrangement with the United States Government to buy silver dollars held in our Treasury. These were melted down and shipped to India, our own Treasury supplies being subsequently replenished by purchase and coinage of new bullion. Thus, for several years Indian silver imports ranged at exceptionally high levels. So long as trade continued active, and prices strong, these supplies were absorbed without difficulty, but with the falling off in business they became more and more redundant, with the consequences as already noted. In other words, silver, like many other commodities, suffers now from having previously gone too high.

Available Stocks of Silver

It is a mistake to suppose that the remonetization of silver would speedily result in large additions to the monetary stocks of the world. As stated above, India and China in recent years have absorbed about 200,000,000 ounces of new silver bullion out of the world's production of about 250,000,000 ounces. The largest stock of silver that is available for purchase is that represented by the redundant coin in the Indian Treasury. This is the coin put into circulation in 1918, and which subsequently has gradually accumulated in the Treasury because not needed in circulation. The total amount of coin and bullion in the Indian Treasury on November 1, 1931, was 452,000,000 ounces, not all of which could be sold. However, 452,000,000 ounces would coin less than 600,000,000 American dollars, and if distributed among the Central banks of the world would be a small addition to the $11,300,000,000 of reserves now held in gold. Shanghai holds a stock of about 200,000,000 ounces, which is somewhat more than is held in peaceful times, but much of this cannot be considered for sale outside of China. There are the scattered hoards in China and India, for which large estimates are made, but they never have been drawn upon for exportation. Of course higher prices for silver would stimulate production which is one of the uncertainties attached to the proposal, but as a means of quickly increasing the world's stock of money the remonetization of silver would not accomplish much.

Factors in the Silver Outlook

With most of the western nations inclined to use silver less and less as money, the key to the future of the metal seems to lie principally in India and China. For such countries, silver is particularly well adapted, both because of the hoarding instincts of the populations and the fact that the great mass of retail transactions is too small for a gold currency. Potential absorptive capacity of these markets is enormous, and silver is likely to respond quickly to any improvement in trade and industrial conditions within those areas. Remonetization of silver by western nations would help the price, of course, but there seems little prospect of such action at this time. In the absence of conclusive evidence that the low price of silver has been an important factor in the depression it hardly seems probable that these countries will want to make such a fundamental change in their banking systems to a less convenient metal solely for the purposes of benefitting silver producers. Similarly, it is doubtful whether at this time, when budgets everywhere are being carefully scrutinized, it would be possible to persuade those countries which have ceased to use silver for subsidiary currency to return to this metal when it is cheaper and just as satisfactory to use paper or alloys.

Safety and Profit in the Banking Business

NO bank can remain long in business nor continue to be a safe haven for the funds of its depositors unless it makes a fair profit from its operations.

The chief source of a bank's earnings is the interest it receives for the use of money loaned. The best secured loans bring the lowest returns, while those involving the greatest risk bring the highest returns. If a banker reaches too far in the direction of profits, he endangers the safety of his deposits. If he leans too far backward in the direction of safety, he chokes off at its source the flow of his major revenue.

Between safety and profit is a delicate balance which banks must always maintain in order to insure both.

The banker's surest guide in this difficult course is the service he renders the community. Helpful, constructive service both to depositors and borrowers will automatically preserve the balance between the two extremes.

The Banks comprising the First National Group in Minneapolis have reached their present size and position of dependability by meeting intelligently and faithfully the legitimate banking needs of this community. You will find them ready and able to give you all the financial help that lies within the power of sound banking institutions.

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This is one of a series of advertisements being published currently by banks of the First National Group in Minneapolis designed to direct the attention of the banking public to certain fundamentals of and current trends in banking.

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